sunwater

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20 August 2021

Charles Millsteed
Chief Executive Officer
Queensland Competition Authority
GPO Box 2257
BRISBANE QLD 4001

Dear Mr Millsteed

Sunwater Limited (Sunwater) welcomes the opportunity to provide comment on the Queensland Competition Authority's (QCA's) rate of return review draft report. This submission focuses on our key areas of concern in relation to the QCA's proposed approach.

Negotiated outcomes

Sunwater does not agree with the QCA's statement that *'Commercial negotiations may not be particularly relevant within all regulatory frameworks, including for example, investigations about pricing practices...'*.[1] In the referral notice to the QCA for the 2020–24 irrigation price investigation, the QCA was required to have regard to agreements reached between Sunwater and customers in relation to costs and/or prices proposed by Sunwater, if the proposed prices were in line with the requirements of the notice.[2] This could potentially have included an agreement on the rate of return.

Given the significant time and resources required by Sunwater and our customers to reach such agreements, Sunwater seeks certainty from the QCA that negotiated outcomes would be taken into consideration when the QCA undertakes an investigation about pricing practices. Alternatively, we suggest that the QCA provide criteria outlining the circumstances in which a negotiated outcome would likely be applied.

Regulatory risk

Sunwater notes the QCA has identified the legislative framework and statutory task as a feature of the regulatory framework that can impact a regulated entity's risk profile. However, the QCA has not explored in its draft report how it will take this risk into consideration when assessing the rate of return, including how it will distinguish between the risks faced by regulated entities subject to different regimes.

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[1] QCA, 2021, *Draft report: Rate of return review*, Brisbane, 28 July 2021, p.10, www.qca.org.au/project/rate-of-return-matters/rate-of-return-review-2021/

[2] Clause (1.5). See www.qca.org.au/wp-content/uploads/2019/05/34157_2018-10-29-DP-Letter-to-QCA-with-referral-notice-003.pdf

As highlighted in our previous submission, the regime currently applying to Sunwater does not provide for explicit legislative triggers and timeframes. This may lead to a gap between the period assumed by the QCA and the actual period over which those prices may be in effect, creating uncertainty for Sunwater which may not be present for other regulated entities.

Sunwater would appreciate greater discussion in the final report about the distinguishing features of each regulatory regime subject to the QCA's purview and how these features will be reflected in the assessment of the rate of return for each regulated entity.

Debt raising costs

The QCA has indicated that the debt raising costs proposed in its draft report may require updating and has asked for material to help validate or update this estimate. The Queensland Treasury Corporation currently charges Sunwater an administration rate of 14.0 basis points per annum, which is added to the interest charge on the cost of debt. Sunwater therefore recommends that the QCA revisit its preliminary view to allow debt raising costs of 9.9 basis points.

Competitive neutrality

Sunwater is subject to competitive neutrality provisions[3] to ensure that we:

- do not have a competitive advantage (or disadvantage) over competitors or potential competitors due to our status as a government-owned corporation
- face the same commercial environment as private sector firms.

This includes a competitive neutrality fee which is imposed on Sunwater to offset any cost of funds advantage we receive. The fee is based on Sunwater's stand-alone credit rating compared against our actual cost of funds, and should result in a cost of debt consistent with a benchmark efficient entity. However, the QCA's cost of debt allowance, which aims to achieve the same outcome, has been consistently lower than our actual cost of debt. Sunwater expects the QCA's proposal to move to a 10-year trailing average, without any transition, will improve this disparity.

Estimating beta

Sunwater recognises that an ongoing challenge for the Sharpe-Lintner Capital Asset Pricing Model is the difficulty in identifying a representative sample of comparator firms, particularly with the small number of domestically listed firms available for use. However, we caution against an over-reliance on internationally listed firms to address this limitation as they are subject to different regulatory arrangements and have different risk profiles. Sunwater maintains that there needs to be a reasonable degree of similarity between the businesses being considered.

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[3] Queensland Government, 2017, *Competitive Neutrality and Queensland Government Business Activities: A Queensland Government Policy Statement July 1996,* Brisbane, 28 July 2021, www.treasury.qld.gov.au/resource/competitive-neutrality-queensland-government-business-activities/

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Further, Sunwater is concerned that Appendix D of the draft report appears to be pointing towards a fixed selection of energy, water and toll road comparator firms that the QCA will use to form beta reference points. Sunwater prefers a less rigid application, with the list refined for each regulated entity at the time of their review to ensure the most appropriate comparators are selected.

Thank you once again for the opportunity to contribute to this process. If you would like to discuss any element of this submission, please contact Rachel Collins, A/Regulatory and Pricing Lead.

Yours sincerely

Cameron Milliner

EGM Customer and Stakeholder Relations

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